LESSON TWELVE
TRADE, INVESTMENT, AND THE BALANCE OF PAYMENTS

LESSON DESCRIPTION

Students use a balance of payments account between two countries, and a hands-on activity that demonstrates the relationship between the current account and the financial account, to understand the relationship between international trade and investment.

INTRODUCTION

The balance of trade for U.S. imports and exports often makes headlines, but does not provide a complete picture of what a balance of trade or current account deficit really is, or the implications of these deficits for other sectors of the economy. This lesson explains the balance of payments and the broader implications of a current account deficit.

CONCEPTS

Balance of payments
Current account
Financial account
Balance of trade
Credits
Debits
Exports
Imports
Investment
Saving

CONTENT STANDARDS

Voluntary exchange occurs only when all participating parties expect to gain. This is true for trade among individuals or organizations within a nation, and among individuals or organizations in different nations.

Money makes it easier to trade, borrow, save, invest, and compare the value of goods and services.

Investment in factories, machinery, new technology, and in the health, education, and training of people, can raise future standards of living.

BENCHMARKS

A nation pays for its imports with its exports.

As a result of growing international economic interdependence, economic conditions and policies in one nation increasingly affect economic conditions and policies in other nations.

As a store of value, money makes it easier for people to save and defer consumption until the future.

Investments in physical and human capital can increase productivity, but such investments entail opportunity costs and economic risks.

OBJECTIVES

Students will:

- Distinguish between the balance of payments, the current account, and the financial account.
- Assign various types of exchanges between countries–including sales of goods and services and assets such as stocks, bonds, and government securities–to the appropriate section of the balance of payments account.
- Explain that a deficit in the current account generally implies a surplus

in the financial account, and vice versa.

- Understand that investment in the United States must be funded from savings in the United States or from the rest of the world.

- Identify some of the potential drawbacks of continued international borrowing by the United States or any other nation.

TIME REQUIRED

Two 50-minute class periods. Class 1, procedures 1–17; class 2, procedures 18–31, Closure, and Assessment.

MATERIALS

- Visual 1: Credits and Debits in the U.S. Balance of Payments
- Visual 2: A Simplified U.S. Balance of Payments Account
- Visual 3: Activity 1 Key
- Visual 4: The Relationship Between the Current Account (CA) and the Financial Account (FA)
- Visual 5: U.S. Balance of Payments, 2004: The Current Account, Selected Items
- Visual 6: The U.S. Current Account Balance as a Percent of GDP
- Visual 7: U.S. Balance of Payments, 2004: The Financial Account, Selected Items
- Visual 8: Sources of Funding for U.S. Investment and Government Deficit Spending, 2004
- Visual 9: The International Investment Position of the United States: A Net Debtor Nation
- Visual 10: Activity 2 Key
- Activity 1: The U.S. Balance of Payments Account (one copy of the first four pages in the activity for every three students in the class, and one copy of the cards on pages 292 and 293 of the activity for each group of three students, cut apart)
- Activity 2: The U.S. Balance of Payments Account with Germany (one copy per student)

PROCEDURES

1. Ask students how the United States pays for imported goods. (If students answer exports commend them; but also accept or explain the pragmatic idea that when people or firms import products they must pay for them with money from the nations in which they are purchased, which means trading dollars for those currencies. Exports do ultimately pay for imports, but exporters are usually different people than importers, so currency trading almost always takes place when goods are imported. In the short term imports may be financed by borrowing from the countries that export to the United States, as shown in the rest of this lesson.)

2. Ask students what kind of money people or firms in the United States would have to get to buy goods and services from the United Kingdom? *(Pounds)* Germany? *(Euros)* Mexico? *(Pesos)* Japan? *(Yen)*

3. Ask why foreign citizens and firms would want to acquire U.S. dollars. (*Foreign citizens or businesses often want to buy U.S. goods and services, or to invest in U.S. financial and capital assets–including stocks and bonds, as well as factories, land, and other real assets.*)

4. Explain that the U.S. **balance of payments** is a record of U.S. purchases of foreign goods, services, and financial and capital assets, and sales of U.S. goods, services, and financial and capital assets to people and firms in other countries.

5. Display Visual 1, and use it to show which items represent a **credit** for the United States in its balance of payments

account, and which items represent a **debit**. Credits are shown with a + and debits with a −. Explain that a credit means that people and firms in other nations must acquire U.S. dollars to pay for these items, while debits mean that people and firms in the United States acquire currencies of other nations to pay for those items. Discuss some of the examples to illustrate how that works. For example, if a foreign company buys all or part of a U.S. company, it must use dollars to pay for the purchase, which generates a credit when the foreign firm buys dollars in the currency exchange markets. If a U.S. company buys all or part of a company in another nation, it has to acquire currency from that nation to pay for the purchase, which creates a debit as it sells dollars to buy the foreign currency in the currency exchange markets.

6. Display Visual 2. Explain that the balance of payments is not organized using categories of credits and debits, but rather using accounts that record trades of goods, services, income payments and receipts, and transfers (called the **current account**) and trades of stocks, bonds, and other financial and capital assets (called the **financial account**). (Transfers are funds that are given with nothing received in return. Examples include U.S. government aid programs and money sent to relatives abroad.) (Note: The term financial account recently replaced what was previously called the capital account. See the appendix to this lesson for more information about that change.)

7. Define surplus and deficit as shown in Visual 2: a surplus occurs if the sum of all items in the current account or financial account is positive; a deficit occurs if the sum of all items in the account is negative.

8. Divide the class into groups of three students. Explain that in each trio one student will play the role of firms and consumers in Spain and the other the role of firms and consumers in the United States. The third student will play the role of a bank. Although it really does not matter where the bank is located in terms of conducting the transactions depicted in this activity, to keep the accounting entries for the transactions clear and easier to follow, tell the students the bank is located in the United States. Assign roles to each student in the teams, or let students choose the roles.

9. Give each group one copy of the cards on pages 296 and 297 of Activity 1, cut apart. Tell the student with the role of U.S. firms and consumers to take all the pieces that are denominated in U.S. dollars (the shaded cards) and spread them out on their desk or table. The student acting as Spain takes the pieces denominated in Euros (the cards that are not shaded). Explain that the bank does not receive any cards, but all currency exchanges must be done at the bank.

10. Distribute one copy of the first four pages of Activity 1 to each team. Tell students to complete the actions for Year 1 and then answer the questions for Year 1 working together. They will trade pieces of paper that represent goods, currency, assets, etc. For example, in the first exchange the student representing the United States firm should give the banker $30. In the second exchange, the Spanish player should give the banker €30. The banker then exchanges the dollars for Euros as described in the third exchange. Make sure students use the trading slips as they work through the activity, because moving the slips from "country" to "country" with the trades makes it easier to complete the next part of the Activity. For example, when Spain buys U.S. corn, the paper representing corn should be placed in front of the Spanish role player, showing that corn has become an export credit for the United States.

11. Explain that the dollar and Euro usually do not trade on a one-to-one exchange rate, but that is done here to keep things simple. Also, again for simplicity, no fee is charged by the bank for the foreign exchange conversions here, but point out that banks actually charge a commission on these transactions.

12. At the end of the deals for the first year, have the student representing the U.S. firms and consumers, with the help of their Spanish trading partner and the banker, record the transactions that were made on the U.S. balance of payments account. Explain that students only have to look at the trading slips in front of them to be able to fill out the balance of payments (BOP) account. For example, U.S. corn was sold to Spain, so that is a credit on the U.S. BOP account, while the machinery purchased from Spain will be a debit on the U.S. BOP account. Explain that, once again to keep things simple, you are not also recording the transactions on a balance of payments account for Spain, though of course that is done too when nations really trade. Clarify to the students that the debits and credits are already marked as – and + in the balance of payments worksheet.

13. After the students have completed the questions for Year 1, review the questions and ask students what the balances in the U.S. current and financial accounts were. (*0–both the current account and financial account were balanced, with no surplus or deficit*.) If necessary, review the fact that in this year Spain traded machinery and received corn in return. Because these trades in goods were of equal value, the current account balance is zero. This also means there was no net change in the ownership of financial assets–all of the currency used to trade ended up back in the country where it was initially held, so the financial account balance was also zero.

14. Tell students to return the trading slips for corn, machinery, and currencies back to the starting points for Year 1, with corn and dollars in the United States, and machinery and euros in Spain. Tell students to complete the transactions for Year 2 and then answer the Year 2 and Review questions on the Activity, once again working as a team.

15. When students have completed the questions, display Visual 3 and review the entries for both years. Then review the Year 2 and Review questions: (*In Year 2, the United States had a $20 deficit in its current account, which was offset by a $20 surplus in its financial account. That leaves the overall balance of payments balanced, with an overall total of 0. Foreign investors buy U.S. securities or financial assets if they expect to get a higher rate of return on those investments, or if they feel that the investments are less risky than investments with similar returns that are available in other parts of the world. Foreign investment provides additional funds that may be used to finance private investments or government spending in the United States, but that means foreigners own more U.S. stocks, bonds, and real assets.*)

16. Ask students: "Was there ever a trade in the Activity when something was sent from one country to the other country without ultimately getting something in return?" (*No. Each card representing goods, currency, or other financial assets was always exchanged for something else–in Year 1 corn was ultimately traded for an equivalent value of machinery. In Year 2, only some of the Spanish textiles were paid for by U.S. corn exports to Spain–the rest of the dollars Spain received for the textiles were held as financial assets.)*

17. Ask students to explain why the sum of the current account and the financial accounts was 0 in both Year 1 and Year 2.

(*Precisely because something is always received for things that are traded to other nations.)* Point out that the balance of payments is set up in such a way that it must balance, so it was no accident that, in this example, the U.S. current account deficit was offset by the financial account surplus.

18. Display Visual 4 and use it to stress the point that the overall balance of payments always "balances," although particular sections of the account may not. For example, if the value of U.S. exports is less than the value of its imports, the dollars that the foreign sellers receive for their goods will be used to invest in U.S. assets such as stocks, treasury securities, or capital assets such as factories and real estate. U.S. imports are "paid for" by U.S. exports or, if the U.S. current account is in deficit, by the sale of U.S. financial assets. Reinforce this idea by noting again that in Year 1 the United States paid for Spanish machinery by exporting corn. In Year 2 the United States paid for Spanish textiles by selling Spain some corn and some U.S. financial assets. (**Notes to teachers:** This example is a simplification of the actual U.S. Balance of Payments in that trade takes place only between the U.S. and Spain. The overall U.S. balance of payments reflects all transactions between the U.S. and the world. The overall balance of payments must equal zero, as shown in Visual 4. However, in real accounts that consider trading between hundreds of countries, the balance of payments between any two countries may not always equal zero, because a deficit with one country could be made up by a surplus with one or more other countries. Using only two countries here to illustrate the overall balance of payments being zero is a simplifying assumption. Also, as explained in the appendix to this lesson, because what is now called the capital accounts section of the balance of payments is a very small part of U.S. accounts it is not included in this activity, once again for simplicity.)

19. Stress that, in the United States or any other country, a current account deficit and financial account surplus are results of choices made by individuals and firms, and by the national government's choices to run a budget deficit by selling treasury bonds or bills. U.S. consumers choose to buy goods and services, including some made in other countries. When they spend more they save less, which leaves fewer domestic funds as savings that can be used to fund investments. By exporting more to the United States than they import from it, foreign citizens and firms choose to invest some of their savings in the United States.

20. Ask students why Spanish investors might purchase U.S. securities. (*U.S. treasury securities may offer a higher interest rate or be seen as less risky than other securities that pay similar rates, and investing in U.S. firms or foreign-owned businesses operating in the United States might offer a higher expected rate of return.)* Note that these choices by consumers and investors are influenced by many factors, including the prices of goods and services in different countries, interest rates paid on savings accounts or bonds, the expected level of profits on investments in different countries, the expected rate of inflation, and political stability and public policies that affect economic conditions.

21. Display Visual 5, which is a simplified version of the U.S. current account for 2004. Explain that indented items are used to show component parts of broader categories. For example, the lines for goods under exports and imports show what part of exports and imports are made up of goods rather than services. Explain that the United States has had a current account deficit since 1991. Over the last decade, its surplus in services has been outweighed by a larger deficit for goods. Note to the students that the news media often reports the **balance of trade**, which is

defined as exports of goods and services minus imports of goods and services. This statistic is based on only part of the current account, because it does not include income payments or net transfers.

22. Display Visual 6 to show historical values for the U.S. current account as a percentage of U.S. GDP. Point out that large deficits in this account have been common for the past 25 years, and especially large in the past 10–15 years.

23. Display Visual 7, which breaks down the Financial Account in the Balance of Payments Account. (Not all subcategories are shown in the table, so the indented items do not equal the totals.) Point out that foreign citizens buy many different types of U.S. assets. Explain that foreign direct investment occurs when foreign individuals or companies buy all or part of a U.S. company, or start or expand their own business in the United States.

24. Ask students if investment is a good thing for the United States and other nations. (*Yes. Investment increases current and future production, creates new jobs, and promotes economic growth.*)

25. Explain that before a nation can invest, someone has to save rather than consume, because if everything produced is consumed there is nothing left to invest. Ask students where they believe funds for investment in the U.S. come from. (*Answers will vary.*)

26. Display Visual 8. Note that in 2004 a large part ($670 billion) of the savings used to finance U.S. private investment and government borrowing came from foreign sources. Stress that, as explained earlier, in order for that to happen the surplus in the U.S. financial account section of its balance of payments account had to be offset by a deficit in its current account, which includes U.S. imports and exports.

27. On Visual 8, also point out that while U.S. private savings are a large source of savings, U.S. savings fell well short of the total amount of borrowing done by U.S. businesses and by the U.S. government, which borrows to cover its budget deficits in many years. In the early years of the 21st century, federal deficits were quite large.

28. Stress again that a current account deficit and a financial account surplus result from choices made by various economic decision makers. Specifically, in 2004:

- U.S. consumers bought more goods and services, including many goods made in other countries, instead of saving to provide more funds for investment.
- The U.S. federal government ran a large budget deficit.
- Foreign investors chose to invest their savings in U.S. government and corporate bonds, or in businesses operating in the United States, rather than buying more U.S. exports of goods and services.

29. Ask students what would have to happen to change a deficit or surplus in the U.S. current or financial section of its balance of payments account. (*Many factors affect the decisions that result in the deficits and surpluses, including household decisions to spend or save; interest rates–which affect both saving and investment decisions; expected profits from investments in the United States and other nations; and political decisions to reduce government borrowing by cutting government spending or increasing taxes*.)

30. Ask students what problems could arise from the continued reliance on foreign savings to fund U.S. investment and government deficits. (*Borrowed funds have*

to be repaid, which will eventually entail a reduction in consumption levels in the United States unless the borrowing funds investments that increase U.S. production by more than enough to repay the borrowed funds.)

31. Display Visual 9. Note that the United States is now a net debtor nation–meaning more assets are owned in the United States by foreign citizens and firms than U.S. citizens and firms own in other countries. Explain that this is directly related to the kinds of trading and borrowing patterns shown in the earlier activity. When the United States runs large current account deficits, more U.S. assets are purchased by foreign investors. If those foreign funds lead to more investments and future growth in the U.S. economy, that can be a good thing for the United States, as it was during the 18th and 19th centuries. But if the foreign borrowing supports more consumption spending by U.S. households and the government, rather than investments in capital projects, the U.S. economy's rate of growth will not increase. In that case the future consumption of goods and services in the United States will have to be reduced when the foreign debt is repaid–perhaps because foreigners become unwilling to hold such a large part of their financial assets in U.S. stocks, bonds, or other assets.

CLOSURE

Review the following points:

- The balance of payments accounts shows that a deficit in the U.S. current account is offset by a surplus in its financial account.
- A current account deficit occurs if a country imports more than it exports.
- A financial account surplus occurs when a country receives more funds for investment from other countries than it sends to other countries.
- The U.S. current account deficit and financial account surplus result from choices made by households, firms, and the federal government. These choices are influenced by interest rates; expected profits; consumer preferences for saving or consuming, and for purchasing domestic or foreign goods and services; and by political decisions about deficit spending.

ASSESSMENT

1. Distribute Activity 2 to each student (or to small groups of students). Ask them to complete the balance of payments table after all the transactions listed have been completed. Remind students to visualize what has happened to the goods, currencies, and financial assets listed, in terms of moving from one country to another.

2. Display Visual 10 and lead a class discussion of the questions on Activity 2: (*The United States receives € 100 for $100, and uses € 70 to buy German stock and € 30 of medical equipment. Both of these transactions are debits on the U.S. balance of payments, the stock in the financial account and the equipment in the current account. Germany uses the $100 to buy $75 worth of wheat and $25 of U.S. Treasury securities. Both of these items are credits in the U.S. balance of payments, the wheat in the current account and the securities in the financial account.)*

3. Ask students whether the current account for the U.S. has a deficit or surplus. *(There is a surplus of $45.)* Ask students whether the financial account for the U.S. has a deficit or surplus. *(There is a deficit of $45.)* Ask students if the United States is sending investment funds to Germany or receiving investment funds from Germany. *(Because there is a deficit in its financial account, the United States is sending funds to Germany, in this case by purchasing German stock.)*

Visual 1
Credits and Debits in the U.S. Balance of Payments

Credits: Dollar values of things the United States sells to citizens or firms in other countries. The citizens or firms in other countries buy dollars to pay for these things. Because the United States receives these payments, they are labeled with a "+" in the U.S. balance of payments account. Examples of things sold include:

- Goods, such as corn, wheat, or machinery
- Services, such as airline travel or insurance
- U.S. securities, such as U.S. Treasury Notes, bonds, or shares of stock in U.S. companies
- Factories or businesses in the United States
- Interest owed to U.S. citizens for their investments abroad

Debits: Values of things U.S. citizens or firms buy from people or firms in other countries. People or firms that make these purchases must buy foreign currency with dollars to make these purchases. Because these payments are made to other countries, they are labeled with a "–" in the U.S. balance of payments account. Examples of things purchased include:

- Goods, such as automobiles, oil, or clothing
- Services, such as U.S. tourists taking a trip to France
- Foreign securities, such as stocks in foreign businesses
- Factories or businesses in other countries
- Interest paid to foreign citizens on their investments in the United States

Visual 2
A Simplified U.S. Balance of Payments Account

Current Account (CA): Summarizes Trade in Goods and Services, Income Payments and Receipts, and Transfers

Exports of goods and services	+ 50
Imports of goods and services	− 100

Financial Account (FA): Summarizes Trade in Assets

U.S. assets owned by foreign citizens	+ 75
Foreign assets owned by U.S. citizens	− 25

The balance of payments is divided into different accounts. An individual account is said to have a surplus if the sum of all the items in the account is positive. It is said to have a deficit if the sum of all the items in the account is negative.

Visual 3
Activity 1 Key

U.S. Balance of Payments

Current Account: Summarizes Trade in Goods and Services, Income Payments and Receipts, and Transfers	**Year 1**	**Year 2**
Exports of U.S.-made goods and services	+ *30*	+ *10*
Imports of foreign goods and services	− *30*	− *30*
Balance of Current Account (Exports – Imports)	*0*	− *20*
Financial Account: Summarizes Trade in Assets		
U.S. assets sold to residents in other nations, including:		
U.S. currency	+	+
U.S. stocks	+	+
U.S. treasury bonds	+	+ *20**
Foreign assets purchased by U.S. residents, including:		
Foreign currency	−	−
Foreign stocks	−	−
Foreign treasury bonds		
Balance of Financial Account (U.S. assets owned by world residents – Foreign assets owned by U.S. residents)	*0*	*20*
Balance of Payments (Current Account + Financial Account) (Should be zero)	*0*	*0*

+ items are credits, − items are debits

* Spain might also have elected to buy U.S. stocks or hold U.S. currency. Note that this does not change the balance of the financial account.

Visual 4
The Relationship between the Current Account (CA) and the Financial Account (FA)

When a country sells something (a good, its currency, or another kind of financial asset), it receives something in return (a good, foreign currency, or another kind of financial asset). On its Balance of Payments account, that means a country's credits must equal its debits. While it may have a balance in one part of the account–for example on the current account–the overall account must be balanced, so the sum of all the accounts within the balance of payments must total zero.

For the United States, which has run a large current account deficit over the past decade, those deficits were offset by surpluses in its financial account. Or put differently, for the United States,

$$\mathbf{CA + FA = 0}$$

[Note: Another part of the balance of payments account, called the capital account, is a very small item for the United States, and so was ignored here. For some countries, the capital account is much larger.]

Visual 5

U.S. Balance of Payments, 2004: The Current Account, Selected Items (in billions of dollars)

	Current Account: Summarizes Trade in Goods and Services, Income Payments and Receipts, and Transfers	
	Exports of U.S.-made goods and services and income receipts	+ 1530
	Goods	+ 807
	Services	+ 344
	Income receipts	+ 380
	Imports of foreign goods and services and income payments	− 2118
	Goods	− 1473
	Services	− 296
	Income payments	− 349
	Net transfers*	− 81
CA	**Balance of Current Account (Exports – Imports – Net Transfers)**	− 668

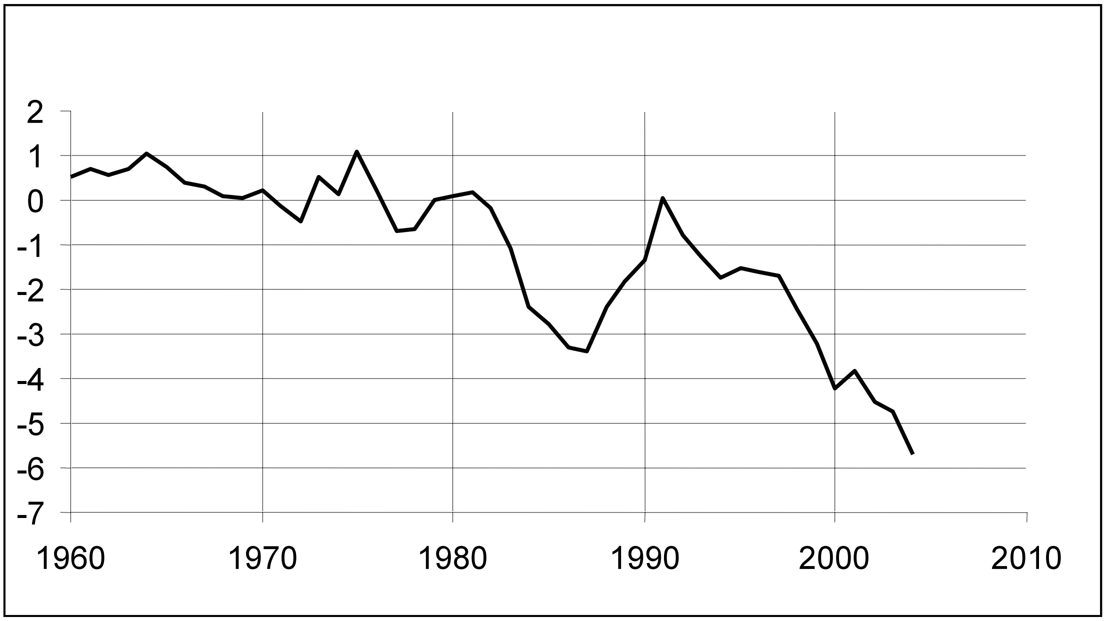
+ items are credits, − items are debits

* Net transfers refer to assistance provided to other nations (foreign aid, for example). That is a debit item, because it sends dollars from the United States to other nations.

The balance of trade in goods and services, which is often reported in news reports, is the value of U.S. exports of goods and services minus the value of U.S. imports of goods and services. The balance of trade in goods and services does not include income payments or receipts or net transfers. The U.S. had a balance of trade deficit of $618 billion in 2004.

Source: www.bea.gov, Table 1: U.S. International Transactions, June 17, 2005.

Visual 6
The U.S. Current Account Balance as a Percentage of GDP



Source: Bureau of Economic Analysis, www.bea.gov, GDP tables, international transactions tables.

Visual 7

U.S. Balance of Payments, 2004: The Financial Account, Selected Items (in billions of dollars)

	Financial Account: Summarizes Trade in Assets*	
	Foreign Assets owned by U.S. residents or government, total:	− 856
	Direct investment	− 252
	Foreign stocks	− 102
	U.S. assets owned by world residents or governments, total:	+ 1440
	U.S. assets held by foreign governments	+ 395
	Direct investment	+ 107
	U.S. currency	+ 15
	U.S. stocks	+ 370
	U.S. treasury bonds	+ 107
FA	**Balance of Financial Account** (U.S. assets owned by world residents – foreign assets own by U.S. residents)	+ 584
SD	**Statistical Differences***	+ 85
CA+ FA+ SD	**Balance of Payments (Current Account + Financial Account)**	0

+ items are credits, − items are debits

* Not all subcategories are shown for Foreign and U.S. Assets, so the total value for those categories is not equal to the sum of the selected items that are shown. Also, because all figures are estimates by the Bureau of Economic Analysis (BEA), and not exact accounting figures, the estimates often do not sum to a zero balance of payments. The "statistical differences" line is used to suggest the overall level of error in the BEA estimates.

Source: www.bea.gov, Table 1: U.S. International Transactions, June 17, 2005.

Visual 8
Sources of Funding for U.S. Investment and Government Deficit Spending, 2004

Investment must be funded by savings, but the saving may be done by people in other countries. Savings are also used to fund government deficits.

In 2004 U.S. private investment spending was $1,930 billion. The sources of those funds were:

	Billions of Dollars
Private savings in U.S.	1760
Government savings in U.S.	− 560
World savings invested in U.S.	670

Note that:

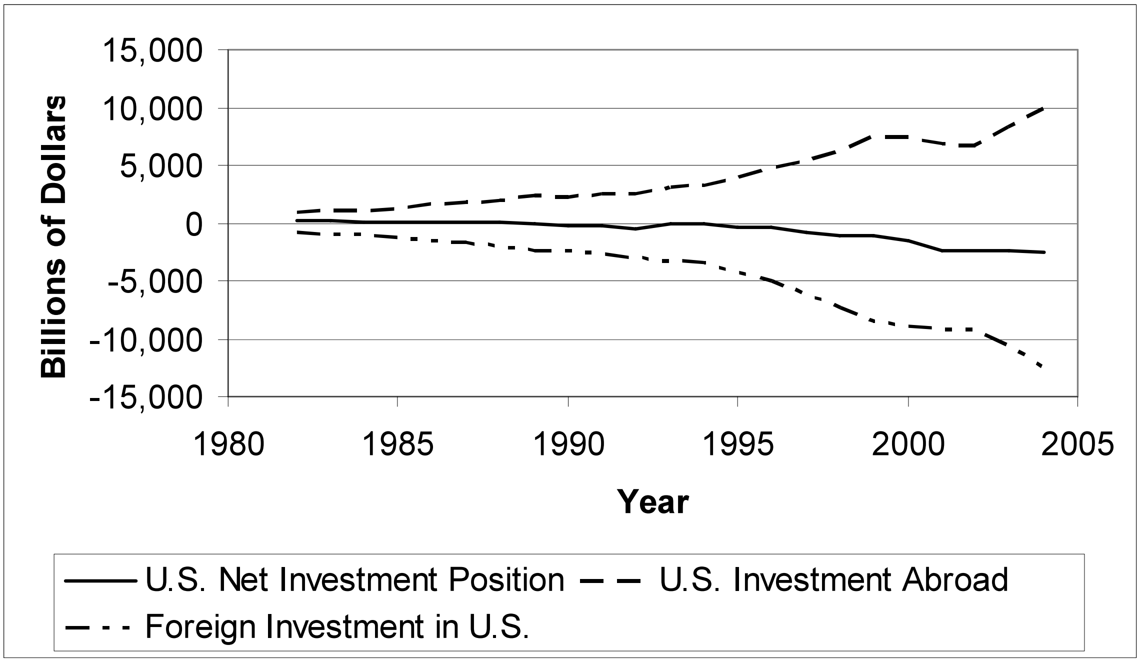
- Savings by U.S. households and firms almost meets private investment.
- Government and businesses are both net borrowers in the United States; households are net savers.
- World savings invested in the United States are taken from the U.S. financial account surplus in its balance of payments account.

Note: Due to statistical discrepancies, rounding, and using an estimate for world savings taken from the international transactions accounts, the value for total savings here is $60 billion less than investment spending and government borrowing.

Source: Bureau of Economic Analysis, www.bea.gov, National Income and Product Accounts, Tables 3.1 and 5.1, and International Transactions Data, Table 1.

Visual 9

The International Investment Position of the United States: A Net Debtor Nation



Source: Bureau of Economic Analysis, www.bea.gov, Table 2. International Investment Position of the United States at Year End.

Visual 10

Activity 2 Key: The U.S. Balance of Payments Account with Germany

Current Account: Summarizes Trade in Goods and Services, Income Payments and Receipts, and Transfers	
Exports of U.S. goods and services	+ 75
Imports of foreign goods and services	− 30
Balance of Current Account (Exports – Imports)	+ 45
Financial Account: Summarizes Trade in Assets	
U.S. Assets sold to residents in other nations, including:	
U.S. currency	+
U.S. stocks	+
U.S. treasury bonds	+ 25
Foreign assets purchased by U.S. residents, including:	
Foreign currency	
Foreign stocks	− 70
Foreign treasury bonds	−
Balance of Financial Account (U.S. assets owned by world residents – foreign assets owned by U.S. residents)	− 45
Balance of Payments (Current Account + Financial Account) (Should be zero)	0

Activity 1
The U.S. Balance of Payments Account

Current Account: Summarizes Trade in Goods and Services, Income Payments and Receipts, and Transfers	**Year 1**	**Year 2**
Exports of U.S. goods and services	+	+
Imports of foreign goods and services	–	–
Balance of Current Account (Exports – Imports)		
Financial Account: Summarizes Trade in Assets		
U.S. assets sold to residents in other nations, including:		
U.S. currency	+	+
U.S. stocks	+	+
U.S. treasury bonds	+	+
Foreign assets purchased by U.S. residents, including:		
Foreign currency	–	–
Foreign stocks	–	–
Foreign treasury bonds		
Balance of Financial Account (U.S. assets owned by world residents – foreign assets owned by U.S. residents)		
Balance of Payments (Current Account + Financial Account)		

items marked + are credits; items marked – are debits.

Activity 1 (continued)

Exchanges in Year 1

Assume that the exchange rate is 1 Euro = $1.

Exchange # 1: A U.S. firm wants to buy machinery from a Spanish firm worth 30 Euros. Have the firm send 30 dollars to the bank to be exchanged for Euros.

Exchange # 2: People and companies in Spain decide to buy corn from the Unites States that costs $30. Have the firm in Spain send 30 Euros to the bank to be exchanged for dollars.

Exchange # 3: The bank exchanges Euros for dollars by giving dollars to Spain and Euros to the United States.

Exchange # 4: The United States buys the machinery from Spain with its Euros.

Exchange # 5: Spain buys corn from the United States with its dollars.

Year 1 Summary: Examine the cards held by each country. Any card that came from the other country represents an international transaction that will be recorded someplace on the Balance of Payments account. Fill in the Year 1 column in the Balance of Payments table for the United States, shown above.

Does the U.S. have a current account deficit or surplus? ______ If so, how much? ____________

Does the U.S. have a deficit or a surplus in its financial account? _______ If so, how much?__________

If the current account and the financial account are added together, what is the total? ___________

What did Spain receive in return for its machinery? ____________

RETURN ALL THE CARDS TO THEIR ORIGINAL COUNTRY. A NEW YEAR IS ABOUT TO BEGIN!

Activity 1 (continued)

Exchanges in Year 2

Assume that the exchange rate is still 1 Euro = $1.

Exchange # 1: A U.S. firm wants to buy textiles from a Spanish firm worth 30 Euros. Have the U.S. firm send 30 dollars to the bank to be exchanged for Euros.

Exchange # 2: People and companies in Spain decide to buy corn from the Unites States that costs $10. Have the firm in Spain send 10 Euros to the bank to be exchanged for dollars.

Exchange # 3: People in Spain want to invest some of their savings in the United States. To do so, they will need to acquire dollars. Have Spain send 20 Euros to the bank to be exchanged for dollars.

Exchange # 4: The bank exchanges the Euros for dollars by giving dollars to Spain and Euros to the United States.

Action # 5: The United States buys the textiles from Spain with its Euros.

Action # 6: Spain buys corn from the United States with its dollars.

Action # 7: Spain buys a U.S. asset worth $20 that will pay savers a good rate of return on the investment.

Year 2 Summary: Examine the cards held by each country. Any card that came from the other country represents an international transaction that will be recorded someplace on the Balance of Payments account. Fill in the Year 2 column in the Balance of Payments table for the United States, shown above.

Does the U.S. have a current account deficit or surplus? _____ If so, how much? ____________

Does the U.S. have a deficit or a surplus in its financial account? _____ If so, how much? __________

If the current account and the financial account are added together, what is the total? ___________

What two things did Spain receive in return for its textiles?
____

Activity 1 (continued)

Review Questions:

Why do you suppose foreign investors, in this example investors from Spain, sometimes decide to buy financial assets (invest) in the United States?

How does the United States benefit from foreign investments?

If the United States continues to run a current account for many years, how will that affect the ownership of financial assets in the United States?

Activity 1 (continued)

Cards

Stock in U.S. Company Worth $20	Stock in Spanish Company Worth € 20
United States Treasury Note Worth $20 Paying 5% Interest	Spanish Treasury Note Worth € 20 Paying 3% Interest
$20 Worth of U.S. Grown Corn	€ 30 Worth of Spanish Machinery
$10 Worth of U.S. Grown Corn	€ 30 Worth of Spanish Textiles

Activity 1 (continued)

Cards (continued)

$10	€ 10
$10	€ 10
$10	€ 10
$10	€ 10

Activity 2
The U.S. Balance of Payments Accounts with Germany

Current Account: Summarizes Trade in Goods and Services, Income Payments and Receipts, and Transfers	
Exports of U.S. goods and services	+
Imports of foreign goods and services	–
Balance of Current Account (Exports – Imports)	
Financial Account: Summarizes Trade in Assets	
U.S. assets sold to residents in other nations, including:	
U.S. currency	+
U.S. stocks	+
U.S. treasury bonds	+
Foreign assets purchased by U.S. residents, including:	
Foreign currency	–
Foreign stocks	–
Foreign treasury bonds	
Balance of Financial Account (U.S. assets owned by world residents – foreign assets own by U.S. residents)	
Balance of Payments (Current Account + Financial Account)	

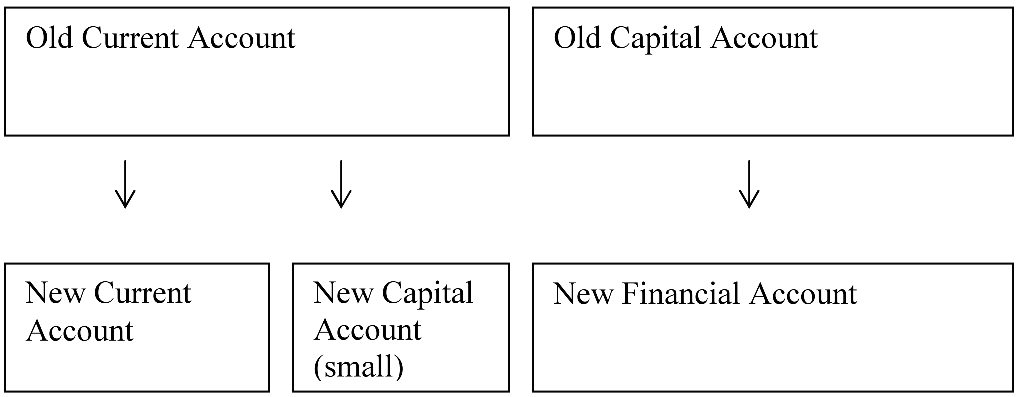
Fill in the figures for the U.S. current account and financial account after the following transactions. Assume the exchange rate is \$1 = €1.

A U.S. company exchanges \$100 for 100 Euros, which are supplied by someone in Germany.

The U.S. company buys €70 of a German company's stock and €30 worth of German medical equipment.

Someone in Germany buys \$75 dollars of U.S. wheat and \$25 worth of U.S. Treasury bonds.

Appendix
Recent Changes in Accounting Procedures and Names of Accounts in the Balance of Payments



In June 1999, the United States changed its classification system for the balance of payments. The new balance of payments is divided into three groups–the current account, the capital account, and the financial account. Under the new system, the old current account is divided into two parts–the new current account (as presented in the lesson) and the new capital account. The new capital account is a record of capital transfers, one example of which is the assets a migrant brings when he or she enters or exits a country. Another example would be debt forgiveness. Because these items are very small for the United States (although important in the balance of payments in other countries), we ignore this category in the lesson.

The old capital account has now been renamed the financial account (as presented in the lesson). For more information see the February 1999 issue of the *Survey of Current Business*, published by the U.S. Department of Commerce.